THE GUARDIAN LIFE INSURANCE COMPANY OF AMERICA
AND
PUBLIC LEASING CORP.
v.
ACTING ANADARKO AREA DIRECTOR, BUREAU OF INDIAN AFFAIRS

IBIA 91-98-A, 91-99-A Decided June 11, 1992

Appeals from a decision withdrawing the entire loan amounts under two loan guaranty certificates.

Affirmed in part; vacated in part; and remanded.

1. Indians: Financial Matters: Financial Assistance--Regulations: Interpretation

Where subsequent legislation renders questionable the continued validity of a Bureau of Indian Affairs regulation, the Board of Indian Appeals will not apply the regulation to the detriment of a party dealing with the Bureau.

2. Indians: Financial Matters: Financial Assistance

Under 25 U.S.C. § 1493 (1988), the Bureau of Indian Affairs may not decline to honor an already-approved loan guaranty on the grounds of lender imprudence. However, under 25 U.S.C. § 1494 (1988), the Bureau may raise certain defenses against a claim under the guaranty.

3. Indians: Financial Matters: Financial Assistance

Under the Bureau of Indian Affairs' loan guaranty program, the failure of a lender to maintain effective liens will diminish the amount of the guaranty to the extent of any loss caused by the lender's failure. 25 CFR 103.28(b).

4. Indians: Financial Matters: Financial Assistance

Arguable Bureau of Indian Affairs imprudence in approving a loan guaranty does not relieve the lender of its obligations under the loan guaranty regulations and agreement.

APPEARANCES: John T. Moshier, Esq., Natalie P. Garth, Esq., and Jeffrey A. Bernick, Esq., Phoenix, Arizona, for appellants; Alan R. Woodcock, Esq., Office of the Regional Solicitor, Southwest Region, U.S. Department of the Interior, Tulsa, Oklahoma, for the Acting Area Director.

OPINION BY ADMINISTRATIVE JUDGE VOGT

Appellants the Guardian Life Insurance Company of America (Guardian) and Public Leasing Corporation (PLC) seek review of an April 25, 1991, decision of the Acting Anadarko Area Director, Bureau of Indian Affairs (Area Director; BIA), withdrawing the entire loan amounts under loan guaranty certificates Nos. B049000045 (certificate 45) and B049000048 (certificate 48) issued to PLC. For the reasons discussed below, the Board affirms the Area Director's decision in part, vacates it in part, and remands this matter to him for further proceedings.

Background

On February 14, 1989, PLC applied at the Horton Agency, BIA, for a loan guaranty to cover a $20,000,000 loan it proposed to make to Construction Technology Corporation (CTC), a corporation chartered by the Sac and Fox Tribe of Missouri. 1/ The purpose of PLC's proposed loan to CTC was stated to be: "Completion of Madden Steel Buildings, Inc. [(Madden)] acquisition * * * consolidation of all debt, expansion of inventory, plant capacity." 2/ This loan guaranty request was denied by the Area Director on August 15, 1989. The denial was not appealed.

On June 23, 1989, prior to denial of its first request, PLC submitted a second loan guaranty request to the Horton Agency, this time for a proposed loan to CTC in the amount of $1,950,000. The request was made following CTC's request to PLC for an "interim" loan. 3/ In a June 27, 1989,

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1/ No copy of the certificate of incorporation for CTC is included in the record. However, according to a June 30, 1989, memorandum from the Regional Solicitor, Southwest Region, to the Area Director, the certificate required that at least 51 percent of the stock of the corporation be owned by the Tribe or its members. This same ownership requirement appears in the record copy of an unsigned certificate of incorporation for Reserve Industrial Authority, the corporate name adopted by CTC in 1990. See infra.

There is conflicting information in the record concerning actual ownership of CTC stock. It appears, however, that stock was issued to some or all of the members of the CTC Board of Directors but later relinquished by them to the Tribe.

2/ Madden was a manufacturer of metal buildings with manufacturing facilities in Oklahoma City, Oklahoma; Burkburnett, Texas; and Center, Texas; and other facilities in Plattsmouth, Nebraska; and Urbana, Illinois. According to appellants, CTC had initiated the acquisition of Madden in 1987.

3/ In a letter to PLC dated June 15, 1989, CTC stated that it had received several orders and needed immediate financing to meet its increase in business. The letter concluded:

letter to BIA, PLC stated: "PLC will make the needed interim loan only with a first lien on the CTC/Madden assets and the BIA guaranty. To enable PLC to accede to a first lien position, existing loan[s] must be paid off. These payoffs are included in the amount of the CTC loan request to us."

In anticipation of approval of a loan guaranty, BIA and PLC executed Loan Guaranty Agreement No. B0089001, dated November 17, 1989, in which PLC agreed to abide by a number of provisions similar to those in 25 CFR Part 103, the regulations governing BIA's loan guaranty program.

While PLC's second loan guaranty request was under consideration, the Anadarko Area Office learned that its loan guaranty ceiling for the remainder of calendar year 1989 would be $1,000,000, but that an additional ceiling might be available to cover the remaining $950,000 of PLC's request after January 1, 1990. 4/ In accordance with the 1989 ceiling, PLC submitted a formal application, dated December 3, 1989, for a guaranty in the amount of $1,000,000. The application stated that the purpose of the loan was “Acquisition of [Madden] and provision of working capital.”

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fn. 3 (continued)

“Utilization of Funds--It will be necessary to clear these notes in order to provide a first lien position on the plants and equipment. All assets except those in Center, Texas and Nebraska will be totally cleared at the time of closing.

Payoff as of 3-31-89	Collateral
164,014	Madden, OKC Plant
177,000	Madden, OKC Plant
49,574	Shields Blvd property
398,642	Madden, Texas Plant
92,248	Morgan bldg.
43,137	Portable assembly plant
165,000	Deferred acquisition cost
860,385	working capital
1,950,000	total.”

PLC replied on June 22, 1989, stating:

“PLC will provide $1,950,000 to use to payoff existing loans on property and equipment and to provide working capital for expansion and retirement of deferred acquisition costs.

“The collateral for the loan must be a first lien on the plants, equipment, inventories, receivables, and investment properties of Madden Steel and the property owned by CTC including the stock of Madden.

*   *   *   *   *   *   *

“This commitment is subject to the execution of mutually accepted documentation and the guarantee of 80% of the loan by the Bureau of Indian Affairs.”

4/ Loan guaranty ceilings for the Area Offices are established by the BIA Central Office in Washington, D.C.

On December 12, 1989, the Area Director issued certificate 45 for a 90-percent guaranty of a $1,000,000 loan. By letter of December 13, 1989, he notified PLC that the guaranty had been approved. PLC and CTC entered into a loan agreement on January 11, 1990. On the same day, PLC and Guardian entered into a "participation agreement," under which Guardian purchased a 90-percent "participation interest" in the loan. Apparently, neither of these documents was submitted to BIA. 5/

In early 1990, CTC changed its name to Reserve Industrial Authority (CTC/RIA) 6/ and acquired PLC; PLC thus became a subsidiary of CTC/RIA. In February 1990, CTC/RIA acquired Madden and in March 1990, it acquired TransLease, Inc., a trucking company with headquarters in Garden City, Kansas.

By letter of March 21, 1990, CTC/RIA informed the Horton Agency that it would seek a second loan guaranty in the amount of $1,000,000. The Area Director notified the Central Office, BIA, of this request and was informed by letter of July 3, 1990, that a $950,000 loan guaranty ceiling would be reserved for it until August 31, 1990. 7/ On August 16, 1990, PLC submitted a formal application for a 90-percent loan guaranty in the amount of $950,000. The application stated that $150,000 of the loan funds would be used for design and construction costs for a transportation service facility near Reserve, Kansas; 8/ $100,000 would be used for working capital in the Reserve, Kansas, area; $350,000 would be used for working capital in the CTC/RIA central offices; and $450,000 would be used for a line of credit for steel inventory.

5/ The Area Director states that he first became aware of Guardian's ownership interest in PLC's loans when Guardian filed its appeal to the Board. Guardian has submitted copies of its participation agreements to the Board during the course of this appeal. The question of whether Guardian was required to notify BIA when it acquired participation interests in the loans is discussed infra in connection with the question of Guardian's standing in this appeal.

The loan agreements have not been submitted to the Board, either as a part of the administrative record, or by any party during the course of this appeal. From statements made by the Area Director, it appears that the agreements were never submitted to BIA. The Board is unable to find any requirement in 25 CFR Part 103 that the parties to guaranteed loans submit copies of their loan agreements to BIA, even though there are provisions in the regulations, such as sections 103.21 and 103.22, which would seem to require that BIA have copies of the agreements.

6/ The Board hereafter uses this joint designation for purposes of convenience, in order to avoid having to distinguish between pre- and post-name change events.

7/ This deadline was formally extended until Sept. 14, 1990, and later extended informally for 5 more days.

8/ This facility was to be constructed on land to be leased from the Tribe.

Upon reviewing the application, BIA staff initially expressed concern because CTC/RIA had experienced a loss of $212,487 during the first half of 1990. There was also concern because PLC was now a subsidiary of CTC/RIA, to which it was proposing to make a loan. However, on September 11, 1990, the Sac and Fox Tribal Council, although it had earlier expressed concern over CTC/RIA's activities, voted to recommend approval of the loan guaranty request. The Superintendent, while expressing reservations, also recommended approval. The Area Credit Officer recommended approval, despite CTC/RIA's recent losses. He stated:

> [C]hanges have been instituted in the management of the three companies and strategic planning sessions have been completed which should orient the companies towards reducing or eliminating unprofitable operations and redirecting the marketing emphasis. At the current rate through the first six months of 1990, the corporation should realize a net profit of $225,000. This profit level is projected to increase significantly in 1991 to $1.4MM and appears to be a realistic forecast since profits should be generated from each of the three companies. A large portion of the 1989 loss can be attributed to a one-time write down of inventory in [Madden]. The marketing plan, sales potential, and financial plan and projections appear to be realistic and achievable.

On September 19, 1990, the Area Director approved the loan guaranty request and issued certificate 48. PLC and CTC/RIA entered into a loan agreement on October 12, 1990. On the same day, PLC and Guardian entered into a participation agreement under which Guardian purchased a 90-percent participation interest in the loan. 9/

In October 1990, the Tribe furnished BIA with a proposed lease for the transportation facility. BIA realty staff reviewed the document and, on January 26, 1991, the Area Director wrote to the Tribe with extensive comments. He concluded that the lease could not be approved as drafted, and recommended that the Tribe employ a standard form of business lease. The record does not show whether a lease was ever executed but, given subsequent events, the Board assumes it was not.

By letter of January 28, 1991, CTC/RIA notified PLC that CTC/RIA owed Federal payroll taxes in the amount of $320,000 plus penalties and interest. CTC/RIA sought additional loan funds from PLC to cover the amount owed. In the same letter, CTC/RIA stated that its purchase of Madden had been rescinded on December 28, 1990.

In an undated letter to the Area Credit Officer, PLC stated that it intended to make a protective advance to CTC/RIA under its loan guaranty agreement and 25 CFR 103.22. Following meetings between PLC, CTC/RIA and Area Office staff, the Area Director wrote to PLC, stating:

9/ These documents, like the earlier ones, were apparently not submitted to BIA.

We regret that we must disallow this notice for a protective advance as it does not meet the criteria for a lender to issue a protective advance. The request for funds originated from the borrower and must therefore be processed as a request for an additional loan. Such request must meet the standards and include the information basically included in a new loan application.

*   *   *   *   *   *

As a result of recent events, we have the following concerns with respect to the two guaranteed loans which were made to CTC/RIA.

1. Use of funds for the loan to CTC/RIA. A total amount of $924,615 was designated for the purpose of paying debts owed by [Madden] with the lender to acquire a first lien position subsequent to this payoff. Our specific concerns are, in light of the rescission of the purchase of [Madden], as follows:

(a) Were the debts paid as stipulated in the use of funds?

(b) What is the present collateral position of the lender with respect to the real property and other assets which were owned by Madden and offered as security for the loan?

(c) What is the present asset and liability status of [CTC/RIA] and its subsidiaries - [PLC], Reserve Transport, and the Facilities Unit of Oklahoma City as compared to the original status and the status immediately preceding the rescission of [Madden]?

(d) What was the amount of cash paid to Mr. Roy Madden as part of the original acquisition of [Madden], and how much of this was returned in the rescission?

2. With respect to the second guaranteed loan, which was made to [CTC/RIA] for $950,000, our concerns are as follows:

(a) Your lenders reports indicate that all of the $950,000 in loan funds were advanced as of October 12, 1990. However, of the above amount, a total of $250,000 was to be utilized for the transportation facilities in Reserve, Kansas. This consisted of $150,000 for construction and $100,000 for working capital. In light of the fact that this facility has not yet been constructed due to the lease not being yet fully approved, we have concerns as to (a) whether the $250,000 has been utilized and (b) how much of the $250,000 remains for use when construction is ready to begin.

(b) The utilization of funds also included $450,000 for revolving steel inventory for [Madden] plus bonding for contracts.

> How much of the funds were utilized for steel inventory, and how much inventory was on hand at the time of rescission?
>
> As you are probably aware, we are greatly concerned as to the issues above as related to the utilization of funds and the monitoring of disbursements by the lender as required by the Loan Guaranty Agreement in effect between you as a lender and [BIA] as a guarantor. Therefore, we would request a response to the issues noted above as well as an accounting for the use of all loan proceeds. Additionally, we also request an accounting of the collateral position for each of the two guaranteed loans and how this compares to the collateral to be taken upon the original loan closings.
>
> Your response to the above issues within the next 30 days would be greatly appreciated so that we may evaluate our status.

(Area Director's Letter of Feb. 28, 1991).

Also during February 1991, the Sac and Fox Tribal Council began to express renewed concern over the management of CTC/RIA. At the Tribe's request, a meeting was held on March 1, 1991, at CTC/RIA's offices in Oklahoma City. The meeting was attended by Tribal Council members, BIA Area Office and Agency staff, and CTC/RIA representatives. Attorneys for the Tribe and CTC/RIA were also present. During the meeting, the tribal attorney asked to see CTC/RIA's books. CTC/RIA initially objected but later produced some books. After some review of the books, the Tribal Council members left the meeting, taking the books with them. The record does not show whether the Tribe ever returned the books to CTC/RIA. 10/

On March 15, 1991, PLC wrote to the Assistant Secretary - Indian Affairs, stating that, on March 13, it had made a protective advance to CTC/RIA in the amount of $195,000 for payment of payroll taxes. The letter made no mention of the earlier communications between PLC and the Area Director concerning the matter. The record does not include any response from the Assistant Secretary to PLC's March 15 letter.

In letters dated March 29 and April 5, 1991, PLC and CTC/RIA submitted partial responses to the questions posed in the Area Director's February 28 letter. PLC also expressed disagreement with the Area Director's February 28 letter insofar as the letter discussed PLC's protective advance to CTC/RIA. CTC/RIA stated, inter alia, that it had no collateral from Madden.

By letter of April 25, 1991, the Area Director informed PLC of his determination that PLC had failed to comply with the terms of the two loan guaranties. He stated:

10/ Although CTC/RIA was nominally a tribal corporation, it is clear from the record that the Tribe exercised little, if any, control over it.

As to [certificate 45], the loan guaranteed was for the purpose of the acquisition of [Madden]. The lender was to acquire a first lien position subsequent to this payoff. Your letter indicates that after payment of these funds, the creditors continued to hold prior liens against [Madden]. The lender did not acquire a first lien. As a result, the entire amount of this loan was not disbursed for the purposes provided in the loan agreement and is therefore excluded from the computation for the amount for which the Lender may be reimbursed in the event of a loss on the loan, as provided by Section 14 of the Loan Guaranty Agreement No. B008901 between [PLC] and [BIA], dated November 17, 1989. [11/] In addition, you have advised that the lender has no collateral as to this loan. As a consequence, your actions do not constitute compliance with the accepted standards employed by prudent lenders in your area, as provided by Section 14 of the Agreement.

As to [certificate 48], the loan guaranteed was for the payment of debts of [Madden] and for the construction of transportation facilities in Reserve, Kansas. You have advised that the purchase of [Madden] has been rescinded by the borrower, CTC/RIA. You have advised that none of the funds paid for the acquisition of [Madden were] returned in the rescission. You have further advised that a portion of the funds of this loan were to be used for the purchase of inventory and that a portion of those funds [was] used to purchase inventory. However, that purchased inventory apparently reverted to [Madden] when that purchase was rescinded and there is no indication that the purchased inventory is in the possession of the borrower or lender.

Finally, you have advised that the transportation facilities in Reserve, Kansas have not been built, but have not given us any information as to the disposition of the funds allocated to said project. Therefore, inasmuch as the entire amount of this loan was not disbursed for the purposes provided in the loan agreement, the entire amount is therefore excluded from the computation for the amount for which the Lender may be reimbursed in the event of

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11/ Section (or Paragraph) 14 of the loan guaranty agreement provides:

"Loan Servicing. The guaranty of a loan by the Commissioner and the issuance of a guaranty agreement will be based on the requirement that adequate loan servicing will be performed by the Lender. * * * Lenders are expected to follow accepted standards employed by prudent Lenders in the area in servicing similar type loans. In servicing loans, Lenders will make every effort to prevent and minimize potential losses. Lenders will use prudence in disbursing loan funds to borrowers to assure, to the extent feasible, that loan funds are used only for the purposes for which the loan is made. Unless approved by the Commissioner, any amounts disbursed for purposes other than those provided in the loan agreement shall be excluded in computing the amount for which the Lender may be reimbursed in the event of a loss on a loan."

> a loss on the loan, as provided by Section 14 of the Agreement. Because the lender has no collateral as to this loan, your actions do not constitute compliance with the accepted standards employed by prudent lenders in your area, as provided by Section 14 of the Agreement. Also, because the lender has a lack of collateral, we are reaffirming our disallowance of your protective advance as stated to you in our letter to you dated February 28, 1991.
>
> We therefore advise you that we are withdrawing the entire loan amounts under these certificates because of your failure to comply with the requirements of Section 14 of the Agreement. In the event of default on either of these loans, you will not be reimbursed by the United States.

(Area Director's Apr. 25, 1991, Decision at 1-2).

The Board received Guardian's notice of appeal from this decision on May 23, 1991, and PLC's notice of appeal on May 24, 1991. 12/ The two appeals were consolidated upon docketing. Guardian and PLC filed joint briefs. The Area Director also filed a brief.

Standing of Guardian

Prior to filing of briefs on the merits, the Area Director moved to dismiss Guardian's appeal for lack of standing. The Area Director argued that Guardian had no legal interest in the loan guaranties because it did not have an approved participation agreement with PLC. In response, Guardian submitted copies of its participation agreements and argued that it met both judicial and administrative requirements for standing. The Board took the Area Director's motion under advisement, stating that it would rule on the motion at the time it issued a decision on the merits.

Under some circumstances, a party may lack standing to pursue an appeal before this Board when the party's claimed interest derives from an unapproved assignment, if the assignment is one for which approval is required by law or regulation. See Farmers & Merchants Bank v. Muskogee Area Director, 21 IBIA 106 (1991); HCB Industries, Inc. v. Muskogee Area Director, 18 IBIA 222 (1990). In this case, there is no regulatory

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12/ On June 21, 1991, a month after filing its appeal, Guardian notified CTC/RIA that it had taken over servicing of CTC/RIA's loans in accordance with the terms of Guardian's participation agreements with PLC. In the same letter, Guardian gave notice that CTC/RIA was in default on its loans.

On July 3, 1991, Guardian filed suit against CTC/RIA in Federal district court, seeking to recover on PLC's loans to CTC/RIA. Guardian also sought appointment of a receiver for CTC/RIA and an order prohibiting CTC/RIA from transferring its assets. On July 12, 1991, the court issued a preliminary injunction prohibiting CTC/RIA from transferring its assets. The Guardian Life Insurance Co. v. Reserve Industrial Authority, No. CIV-91-1014-T (W.D. Okla.).

requirement that participation agreements be approved by BIA. However, there is a question as to whether Guardian was required to notify BIA of its acquisition of an interest in the loans. If Guardian was required to do so and did not, it may lack standing here.

25 CFR 103.51 provides:

> Any guaranteed loan, including the security and guaranty certificate, may be sold, assigned, or transferred by the lender to any financial institution that is subject to examination and supervision by an agency of the United States, a state or the District of Columbia. The institution acquiring the loan shall notify the Commissioner in writing within 30 days after acquisition. The notice will give the name of the borrower, the certificate number, the amount of principal and interest unpaid on the loan, and the security acquired. Failure of the acquirer to notify the Commissioner within 30 days of acquisition will void the guaranty unless the Commissioner authorizes an exception because of extenuating circumstances.

The Area Director argues that Guardian's participation agreements with PLC make Guardian an assignee under this provision. Accordingly he contends that Guardian's failure to notify BIA of its acquisitions not only deprives it of standing in this appeal but also voided the guaranties.

Appellants contend that the notice provision of section 103.51 has been superseded by subsequent legislation.

Section 103.51 is based on the original version of 25 U.S.C. § 1485 (1976), which provided: "Any loan guaranteed hereunder including the security given therefor, may be sold or assigned by the lender to any financial institution subject to examination and supervision by an agency of the United States or of any State or the District of Columbia." In 1988, this statutory provision was amended to read: "Any loan guaranteed under this subchapter, including the security given for such loan, may be sold or assigned by the lender to any person." 25 CFR 103.51 has not been revised to take this amendment into account. Appellants contend that the notification requirement is no longer valid because it is inconsistent with Congress' intent to remove restrictions on lenders to whom guaranteed loans may be sold or assigned.

[1] It is arguable that the notification provision of section 103.51 is still valid and is now applicable to "any person," to correspond to the statutory revision of the first sentence of the section. It is also arguable, however, that the notification provision was intended only to allow BIA to ensure that the acquiring institution met the requirements of the original version of 25 U.S.C. § 1485 (1976). Congress' 1988 change to the sale/assignment authority was substantial. Because BIA has not yet revised its regulation, the Board does not have the benefit of BIA's interpretation of the change and its view as to whether the earlier notification requirement is consistent with the new statutory language. Under these circumstances, and in light of the drastic consequences of a lender's failure to

comply with the notification provision, the Board declines, for purposes of this appeal, to construe the provision as having survived the statutory amendment so as to require Guardian to report its acquisition of an interest in the guaranteed loans to BIA. 13/

Appellants also argue that the participation agreements between PLC and Guardian are not sales, assignments or transfers within the meaning of section 103.51. In light of the conclusion just reached, the Board need not address this contention at length. It observes, however, that the agreements themselves describe the transactions in terms of sales of interests in the guaranteed loans. 14/ The Board also observes that, by denying that the transactions were sales or assignments of the guaranteed loans, appellants appear to be denying that the transactions are among those transactions authorized by 25 U.S.C. § 1485 (1988), 15/ a seemingly odd position for appellants to take, as it leads directly to the question of whether the transactions were authorized at all. The Board rejects appellants' contention and concludes that the transactions concerned fall within the authorization of the statute. The Board therefore concludes that Guardian has standing to pursue this appeal.

Discussion and Conclusions

Appellants argue: (1) the Area Director's action was precluded by 25 CFR 103.53; (2) the record does not support the Area Director's conclusions that PLC acted imprudently or disbursed funds in violation of the loan agreements; and (3) the procedures followed by BIA in withdrawing the loan guaranties deprived appellants of property without due process of law.

25 CFR 103.53, cited by appellants, is based on 25 U.S.C. § 1493, which provides:

> Whenever the Secretary finds that any lender or holder of a guaranty certificate fails to maintain adequate accounting records, or to demonstrate proper ability to service adequately

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13/ The Board does not hold that BIA may not, through new rulemaking, require that notice be given when a sale or assignment of a guaranteed loan is made to "any person." It holds simply that the status of the present notification provision is too unclear to permit invoking it to void appellants' guaranties or deprive Guardian of standing in this appeal.

The Board notes that BIA published a proposed revision of Part 103 in the Federal Register on Sept. 23, 1991, 56 FR 48082. This proposal does not include any changes to section 103.51.

14/ Further, the agreements authorize Guardian to assume active responsibility for servicing the loans. Citing the agreements, Guardian took this step on June 21, 1991. See note 12 supra.

15/ All further references to the United States Code are to the 1988 edition.

> loans guaranteed or insured, or to exercise proper credit judgment, or has willfully or negligently engaged in practices otherwise detrimental to the interests of a borrower or of the United States, he may refuse, either temporarily or permanently, to guarantee or insure any further loans made by such lender or holder, and may bar such lender or holder from acquiring additional loans guaranteed or insured hereunder: Provided, That the Secretary shall not refuse to pay a valid guaranty or insurance claim on loans previously made in good faith. [16/]

Appellants argue that this provision precludes the action taken by the Area Director. While denying that any misconduct occurred in this case, appellants contend that the Secretary is required by this provision to honor a guaranty when a lender's misconduct occurs after the guaranty has been issued.

The Area Director contends that his action was authorized by 25 U.S.C. § 1494, which provides:

> Any evidence of guaranty or insurance issued by the Secretary shall be conclusive evidence of the eligibility of the loan for guaranty or insurance under the provisions of this chapter and the amount of such guaranty or insurance: Provided, That nothing in this section shall preclude the Secretary from establishing, as against the original lender, defenses based on fraud or material misrepresentation or bar him from establishing, by regulations in force at the date of such issuance or disbursement, whichever is the earlier, partial defenses to the amount payable on the guaranty or insurance.

[2] It is clear from these two sections, read in tandem, that the usual penalty for lender imprudence is the one described in section 1493, i.e., temporary or permanent ineligibility for future guaranteed loans, and that, only in the specific circumstances identified in section 1494, may BIA decline to honor an approved loan guaranty.

The Area Director contends that the circumstances described in section 1494 are present in this case. He alleges that PLC engaged in fraud or material misrepresentation when it stated in its loan guaranty request that the purpose of its $1,000,000 loan to CTC/RIA was to acquire Madden. 7/ This fraud or misrepresentation is shown by, the Area Director contends, the fact that PLC later allowed CTC/RIA to rescind the acquisition without

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16/ The language of 25 CFR 103.53 is virtually identical to that of the statute.

17/ The "fraud or material misrepresentation" provision of 25 U.S.C. § 1494 is implemented by 25 CFR 103.49, which provides:

"(a) Lenders shall use prudence in checking and verifying information contained in loan applications as well as supporting papers and documents in order to assure their accuracy and the validity of signatures.

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recovering any of the consideration given for the acquisition of Madden. The Area Director further alleges that PLC acted as agent for Guardian when engaged in its acts of fraud or misrepresentation and that Guardian directly participated in PLC's misconduct.

Much remains to be explained about the acquisition and disposal of Madden. There are also unanswered questions concerning the possible involvement of Guardian during the guaranty application stage, especially in light of its prompt appearance on the scene following approval of the guaranties. <u>See also</u> note 23, <u>infra</u>. There is, however, no proof in the record as presently constituted that fraud or material misrepresentation was either engaged in by PLC or participated in by Guardian. Even so, as further discussed below, enough questions are raised by the facts in this case to warrant investigation of the possibility that fraud or misrepresentation occurred. At this point, the Board reaches no conclusions about the presence or absence of fraud or misrepresentation in this matter.

The Area Director next contends that partial defenses are available to him in two provisions of 25 CFR Part 103 which implement the last clause of 25 U.S.C. § 1494. These are 25 CFR 103.28(b) and 103.46. The Area Director argues that these two provisions incorporate the "prudent lender" rule cited in his decision.

Section 103.28(b) provides in part:

> Lenders must also see that: (1) Effective liens are maintained at all times; (2) taxes on the property included in the securing instruments are paid promptly to prevent such taxes from becoming a lien taking priority over a mortgage; and (3) hazard and liability insurance is obtained * * *. Failure of a lender to discharge any of these responsibilities will diminish the amount of the guaranty or insurance to the extent of any loss caused by the lender's failure, unless there are extenuating circumstances which in the judgment of the Commissioner do not justify a reduction of the amount guaranteed or insured.

[3] This section requires that lenders maintain effective liens. Appellants make no attempt to show that they have done so. Instead, they

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fn. 17 (continued)

"(c) There shall be no liability on the part of the United States to reimburse a lender on a guaranteed loan for that amount of the guaranteed loss caused by (1) the lender's negligence in checking and verifying signatures, information in the loan application, supporting papers and documents; (2) the lender's furnishing false information to induce the issuance of a guaranty certificate by the Commissioner; or (3) the lender's willful or negligent action which permitted a fraud, forgery or misrepresentation. A reduction will not be made in the amount of reimbursement on a guaranteed loss to a purchaser, assignee or transferee who acquired the loan before maturity for value and did not directly or by agent participate in or have prior knowledge of a fraud, forgery or misrepresentation."

contend that this regulatory requirement is not applicable to a failure to obtain liens, but only to negligence in perfecting or recording liens. (Appellants' Reply Brief at 10-11). They cite no support for this interpretation. It would be odd indeed for BIA to provide by regulation for a defense in the case of a negligent failure to record a lien but not for a negligent or intentional failure to obtain a lien in the first instance. The Board declines to adopt appellants' narrow construction of this provision and finds that a defense is available to BIA under section 103.28(b) against a lender who fails to obtain a lien, to the extent of any loss caused by that failure.

Appellants further contend, however, that in this case there was no requirement that PLC obtain any liens because the only representation PLC made to BIA that it would do so was in its application for a loan guaranty in the amount of $1,950,000. Appellants appear to contend that when the loan amount was reduced to $1,000,000, CTC/RIA did not receive sufficient funds to pay off all outstanding debts on the Madden property (as listed in CTC/RIA's June 15, 1989, letter to PLC, see note 3) and was therefore relieved of the obligation to obtain liens on any of the property. (Appellants' Reply Brief at 19-20).

The record indicates that, following PLC's submission of its written application for a loan guaranty, PLC and BIA continued to discuss the loan conditions for some time, making adjustments to accommodate, inter alia, the reduced amount of the loan. PLC's President stated in a letter to BIA dated December 3, 1989: "I have worked out the changes with Roy and Clo Madden and the lenders. [CTC/RIA] will assume the existing debt on [Madden's] I-240 and Burkburnett plants; Madden will keep the portable building sales yards; and three small payables will be paid off." If CTC/RIA did assume the existing debt on the two plants, as PLC represented, there should have been no obstacle to PLC's obtaining a first lien on those properties, whether or not it was able to obtain liens on the other properties listed in the June 15, 1989, letter.

To be sure, the record here does not include any written commitment by PLC, dating from the time after the loan amount was reduced to $1,000,000, to obtain liens on Madden property. It is apparent that communications between PLC and BIA at that point were primarily oral. In the credit memorandum prepared by the Area Credit Officer on December 8, 1989, it is indicated that the collateral for the loan would be $384,224 in land and buildings, $317,611 in machinery and equipment, and $958,742 in inventory. The specific collateral is not identified. Appellants argue that they cannot be bound by internal BIA documents, such as the credit memorandum. Appellants have had access to the credit memorandum during the course of this appeal and have failed to attempt a refutation of the information contained in it by, for instance, production of the loan agreement itself. 18/ For purposes of this appeal, the Board

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18/ Of course, even if the loan agreement failed to provide for security, that would not prove that PLC did not represent to BIA that it would require security from CTC/RIA.

considers appellants to have conceded the essential factual accuracy of the BIA credit memorandum and, as to this issue, that memorandum's accurate representation of PLC's commitment to BIA with regard to security.

Even if PLC made no explicit commitment to BIA that it would require security and obtain liens, it would not be relieved of the obligation it had in that regard under the regulations and the loan guaranty agreement. Appellants argue, however, that there is no regulation that requires guaranteed loans to be secured.

25 CFR 103.27 provides: "Lenders will require borrowers to give security, if available, up to an amount adequate to protect the loan, without consideration of the guaranty or insurance." Paragraph 7 of the loan guaranty agreement between PLC and BIA provides:

> Security for Loan. Lenders shall require borrowers to provide sufficient security, if available, to adequately secure the loan, without consideration of the loan guaranty.
>
> * * * * * *
>
> Lenders shall require any property purchased with the proceeds of a guaranteed loan, except land purchased by a tribe, title to which is taken in trust or restricted status, to be mortgaged to the Lender as security for the loan, unless the loan is otherwise adequately secured.

Appellants appear to contend that 25 CFR 103.27 did not require PLC to obtain security from CTC/RIA. The only possible basis for such an argument would be that no security was available. However, such a contention would not appear to be a credible one in the circumstances of this loan, the purpose of which was to acquire property. Further, even if the phrase "if available," as it appears in the regulation or in the first sentence of Paragraph 7 of the loan guaranty agreement, is deemed to make those sentences ambiguous, there is no ambiguity in the final sentence of Paragraph 7 of the loan guaranty agreement. PLC was explicitly required by this sentence to obtain a mortgage on the Madden property acquired with the loan proceeds, unless the loan was otherwise adequately secured.

The Board holds that PLC was required by 25 CFR 103.27 and Paragraph 7 of its loan guaranty agreement to obtain security from CTC/RIA. It was required by 25 CFR 103.28(b) to maintain effective liens. Under section 103.28(b), BIA may decline to honor the guaranties to the extent of any loss caused by PLC's failure to maintain effective liens. 19/

19/ Apparently, PLC also failed to obtain liens with respect to the second loan. The collateral for the second loan, as shown in the BIA credit report, was to be $50,000 in machinery and equipment, $633,265 in accounts receivable, and $479,665 in inventory. Insofar as liens could have been obtained on this collateral but were not, BIA may decline to honor its guaranty to the extent of any loss caused by that failure.

The Area Director also argues that a partial defense is available under section 103.28(b) because of the failure of CTC/RIA to pay payroll taxes, a failure which could have resulted in a tax lien upon CTC/RIA assets. Section 103.28(b), however, refers only to taxes on property, in fact, only to taxes on the property used as security: "Lenders must * * * see that: * * * (2) taxes on the property included in the securing instruments are paid promptly to prevent such taxes from becoming a lien taking priority over a mortgage." Even though delinquent payroll taxes might well result in a lien on property, this provision of section 103.28(b) simply cannot be construed to extend to payroll taxes. Accordingly, the Board holds that no defense is available under this section based on CTC/RIA's failure to pay payroll taxes.

The second regulatory provision relied upon by the Area Director, 25 CFR 103.46, provides:

> The guaranty or insurance of a loan by the Commissioner and the issuance of an insurance agreement will be based on the requirement that adequate loan servicing will be performed by the lender. * * * Lenders are expected to follow accepted standards employed by prudent lenders in the area in servicing similar type loans. In servicing loans, lenders will make every effort to prevent and minimize potential losses. Lenders will use prudence in disbursing loan funds to borrowers to assure, to the extent feasible, that loan funds are used only for the purposes for which the loan is made. Unless approved by the Commissioner, any amounts disbursed for purposes other than those provided in the loan agreement shall be excluded in the [sic] computing the amount for which the lender may be reimbursed in the event of a loss on a loan.

The Area Director argues that a partial defense is available under this section because loan funds were not used for the purposes for which the loans were made. The Area Director contends that the fact that Madden was later disposed of indicates that the funds disbursed under the first loan were not used for the purpose intended, i.e., the acquisition of Madden. He also argues that $250,000 of the second loan, which was supposed to have been used for a transportation facility, could not have been used for that purpose because the entire loan amount of $950,000 was disbursed and no transportation facility was constructed.

With respect to the Madden acquisition and disposal, appellants contend that there was no violation of section 103.46 because Madden was in fact acquired with the loan funds. Given the fact that Madden was so acquired, and the fact that there is no evidence in the present record that the acquisition and disposal were not made in good faith, the Board cannot find at this point that there was a violation of section 103.46 in this regard. However, the question of whether the acquisition and disposal were made in good faith is closely related to the question of whether fraud or misrepresentation is involved in this matter. If an investigation is undertaken with respect to possible fraud or misrepresentation, and if that investigation shows a lack of good faith in the acquisition and disposal of Madden, it would appear that a defense should be available to BIA under section 103.46, as well as under section 103.49, against either or both of appellants shown to have been lacking in good faith.

With respect to the portion of the second loan intended for a transportation facility, appellants state that they "vehemently deny" that the funds were improperly expended. (Appellants' Opening Brief at 35). However, they do not claim that the facility was constructed, do not deny that the funds were paid out, and offer no explanation for what became of the funds. Under these circumstances, the Board finds that appellants have conceded that the $250,000 was not used for the purpose for which the loan was made. Therefore, the Board concludes that a partial defense is available to the Area Director under section 103.46 with respect to this $250,000.

Appellants argue that the Area Director erred in disallowing the amount of the protective advance made by PLC to CTC/RIA They contend that the advance was proper under 25 CFR 103.22. Section 103.22 provides:

> When provided for in a loan agreement, and subject to the limitations on the amounts and terms of loans as provided in §§ 103.13, 103.14, and 103.24, lenders may advance, for certain purposes, up to 10 percent of the amount for which a guaranteed or insured loan originally was approved. If the borrower is unable to provide the funds or refuses to do so, an advance may be made for purposes necessary and proper for the preservation, maintenance or repair of the property purchased with or given to secure the loan; for accrued taxes, special assessments, ground and water rents, and hazard and liability insurance premiums; and for any other purpose necessary for the protection of the interest of the lender or borrower. The additional advance will be charged against the borrower. Repayment of the protective advance shall be automatically guaranteed or insured at the same percentage rate as applied to the original amount of the loan upon the Commissioner's receiving notice from the lender that an additional amount has been advanced with a statement as to the necessity and purpose(s) of the advance.

Appellants argue that PLC's decision to make the protective advance was prudent because CTC/RIA could not have survived without it. The Area Director argues that section 103.22 was not intended to allow borrowers to increase the amount of their loans simply by refusing to pay Federal taxes. He argues further that there is no evidence that CTC/RIA lacked the funds to pay the taxes.

As peculiar as it may seem, it appears that section 103.22 does permit a borrower to refuse or neglect to pay taxes and thereby set into motion a course of events leading to a 10-percent increase in its loan, assuming the lender is willing. Further, it is clear from the language of section 103.22 that BIA approval of protective advances is not required. <u>See also</u> section 103.21, concerning loan modifications, which excepts loan increases pursuant to section 103.22 from the requirement of BIA approval for increases in the principal amount of a loan. 20/

None of the parties discuss the requirement in section 103.22 that, in order for a protective advance to be made, there must be a provision authorizing it in the loan agreement. Because the loan agreements between PLC and CTC/RIA are not a part of the record, it is not possible to determine whether or not protective advances are allowed under those agreements. As it happens, however, the provisions of the loan agreements on this point are not critical. This is because the loan guaranty agreement between PLC and BIA does not require that protective advances be provided for in a loan agreement. 21/ BIA is bound by its own contracts as long as the contracts are not in conflict with governing regulations. E.g., Abbott v. Billings Area Director, 20 IBIA 268 (1991). Here, it is arguable that the loan guaranty agreement and the regulations are in conflict. However, the form loan guaranty agreement used here was taken from the BIA Manual (BIAM). Provisions of the BIAM may be enforced against BIA. E.g., Carter v. Acting Billings Area Director, 20 IBIA 195 (1991). Here, when the BIAM provision is also a matter of contract between BIA and the lender, the Board holds that BIA must be deemed to have waived the regulatory requirement that authority for protective advances appear in the loan agreement.

The Board holds that BIA had no authority to disapprove the protective advance made by PLC to CTC/RIA.

So far, the Board has (1) declined, in light of 25 U.S.C. § 1493, to recognize any authority in the Area Director to cancel the loan guaranties outright on the basis of lender imprudence; (2) declined, based on the present record, to find that PLC and/or Guardian engaged in fraud or misrepresentation; (3) rejected some of the Area Director's claimed partial defenses against payment on the guaranties but recognized that BIA may raise two partial defenses, i.e., to the extent of any loss caused by PLC's failure to maintain effective liens and by exclusion of the $250,000 intended for the construction of transportation facilities; and (4) held that the Area Director lacked authority to disapprove the protective advance to CTC/RIA.

20/ 25 CFR 103.21(a) provides:

"Guaranteed and insured loans may be modified with the approval of the parties to the original loan agreement. Modification of guaranteed loans * * * requires the Commissioner's approval only if the modification involves * * * (5) increase in the principal amount of a loan, except as provided in § 103.22."

21/ Paragraph 16 of the loan guaranty agreement provides: "Protective Advances. Subject to the limitations on the amounts and terms of loans, the Lender may advance, for certain purposes, up to 10 percent of the amount for which a guaranteed loan was originally approved."

There are other discrepancies between the form loan guaranty agreement and the regulations. For instance, Paragraph 15 of the agreement requires BIA approval for any modification of the loan agreement, whereas 25 CFR 103.21 requires approval only for certain kinds of modifications.

Appellants also argue that the manner in which the Area Director issued his decision deprived them of property without due process of law. They contend that they were entitled to notice and an evidentiary hearing before the Area Director issued his decision. They contend further that BIA is not equipped to issue decisions of this nature in accordance with the requirements of due process. 22/

The Area Director's decision in this case was procedurally unusual and was, in some respects, premature. He did not wait for the lender to make a claim against the guaranty but announced ahead of time that he did not intend to honor the guaranty. It is clear that the Area Director was convinced that some action was required, even though not explicitly provided for in the regulations, in view of what he perceived to be rapidly approaching disaster. And if his decision served no other purpose, it appears to have alerted Guardian to the problem and inspired it to initiate a salvage action. See note 12, supra.

In light of the disposition of this appeal, the Board need not address appellants' due process arguments in detail. The Board observes, however, that, while PLC may not have had explicit notice that the Area Director was going to issue a decision, it was certainly on notice that BIA was concerned about its activities. Further, PLC was given ample opportunity to submit information relating to the identified areas of BIA's concern. Guardian can hardly have expected to receive notice from BIA when it had not informed BIA that it had purchased interests in the loans. As to appellants' argument that the Area Director was required to conduct an evidentiary hearing, the Board has stated on a number of occasions that evidentiary hearings before BIA are not required in all cases where property rights are affected. It has further stated that an appellant's due process rights are protected by the right to appeal a BIA decision to this Board. E.g., All Materials of Montana, Inc. v. Billings Area Director, 21 IBIA 202 (1992), and cases cited therein.

One further argument made by appellants must be addressed. Throughout their briefs, appellants contend that BIA was imprudent in approving the loan guaranties in the first instance and suggest that this imprudence somehow relieved appellants of any obligation to behave as prudent lenders or to abide by the loan guaranty agreement and the regulations in Part 103. 23/

22/ Appellants seem particularly incensed that there is no procedure under BIA or Board regulations for subpoena of witnesses and that appellants therefore had no opportunity to interrogate BIA employees. To be sure, as noted above, there is a need for more facts than are in the present record, perhaps including the testimony of witnesses. Yet it appears to the Board that the critical missing facts here are not in the custody of BIA, but rather in the custody of appellants and/or CTC/RIA.

23/ At one point, appellants contend that BIA made "a very stupid and irresponsible lending decision" (Appellants' Opening Brief at 32). For PLC to thus characterize BIA's decision to guarantee PLC's loan is, to say the least, intriguing. It also raises serious questions as to PLC's good faith in seeking the loan guaranty.

Specifically, appellants state that PLC was in an obvious conflict of interest situation and that other information available to BIA should have warned it that CTC/RIA was not creditworthy.

To be sure, there is evidence in the record that BIA knew the loans to CTC/RIA might be risky. However, some risk is to be expected in any loan under the BIA guaranty program. The very purpose of the program is to assist Indians who are unable to obtain financing in the commercial market without a guaranty.

[4] More questionable is BIA's disregard of the close relation between PLC and CTC/RIA, especially its approval of the second loan guaranty after PLC had become a subsidiary of CTC/RIA. It is hard to imagine how PLC could have been expected to maintain an arms-length relation with its borrower under these circumstances. However, BIA's approval of the guaranties, while perhaps unwise, did not relieve PLC of its obligations under the regulations or the loan guaranty agreement.

A similar circumstance was addressed in Citizens Marine National Bank v. United States Department of Commerce, 854 F.2d 223 (7th Cir. 1988). In that case, the Economic Development Administration (EDA) had refused to make good on a guaranty it had issued under the Trade Act of 1974. In a claim filed by the lender bank against the government, the district court held in favor of the bank, in part because, as phrased by the court of appeals, "although the bank had behaved imprudently in administering the loan, so had the government." 854 F.2d at 225. The court of appeals reversed, stating:

> The district court believed that in any event the bank's imprudence was somehow cancelled by the government's. Three ideas seem merged here: that the government broke its side of the bargain; that by winking at the bank's carelessness the government in effect modified the guaranty agreement; that the

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fn. 23 (continued)

Guardian appears to concede, in making allegations of this nature, that it too made "a very stupid and irresponsible lending decision." While it claims innocence of any involvement in the initial arrangements and states that it "relied on the BIA's underwriting and analysis and the issuance of the guaranty as an inducement to acquire its interest" (Appellants' Opening Brief at 9), its participation agreements portray a more involved role for Guardian. Paragraph 4.E of each agreement provides:

"Participant [i.e., Guardian] represents that Participant has examined, or has been afforded the opportunity to examine, all documents evidencing, securing and relating to the Loan to include all Loan Documents and loan application documents; that it has made an independent judgment of the credit risks involved in the Loan and the security for the Loan, and that it has purchased its Participation Interest without reliance on any representations or warranties of Principal [i.e., PLC], express or implied, other than such representations and warranties are expressly sent forth in this Participation Agreement."

> government is in any event estopped by its conduct to complain of the bank's breach.
>
> The government had received a copy of [the borrower's] financial statement before the loan closed, and could have withdrawn from the deal but didn't. And the employees of the [EDA] who supervised the transaction with the bank became aware of many of the bank's imprudent practices yet turned a blind eye. But nothing in the guaranty agreement enjoins the guarantor to vigilance which scotches the suggestion that the government is guilty of a breach of contract too. Nor had these subordinate officials of the [EDA] who exercised inadequate oversight in this matter any actual or apparent authority to modify the terms of the guaranty. * * * The failure of the [EDA]'s regional staff to insist upon compliance with [a provision in the guaranty agreement concerning lender prudence] does not open the vaults of the Treasury to a bank that violated the provision.
>
> The question whether and in what circumstances the federal government can be estopped by an act of its agents remains unsettled, but it is at least clear that "however heavy the burden might be when an estoppel is asserted against the Government, the private party surely cannot prevail without at least demonstrating that the traditional elements of an estoppel are present." * * * That sinks the bank's estoppel argument, for there were no promises, misrepresentations, or misleading silences, and there was no reliance by the bank. * * * The government did not come down hard on the bank's imprudent practices, but neither did it direct or encourage them. [Citations omitted.]

854 F.2d at 228-29.

It is true, as appellants contend, that Citizens Marine National Bank concerned a loan guaranty under an agreement which, unlike a BIA loan guaranty, permitted revocation for lender imprudence. Even so, the court's analysis of the effect of "government imprudence" is relevant here. As in Citizens Marine National Bank, the duties at issue here are imposed upon PLC not BIA. The arguably imprudent BIA employees and officials had no authority to modify either the regulations or the loan guaranty agreement. Finally, there is no basis for a finding of estoppel here. 24/

24/ Appellants do not make an explicit estoppel argument. Possibly, Guardian intended to imply such an argument in its claim to be an innocent third party acting in reliance upon the BIA guaranty. As observed in note 23, however, Guardian's claim to reliance upon BIA's analysis of the loans is refuted by its statement in its participation agreements. Further, Guardian cannot claim ignorance of the regulatory requirements placed upon lenders, since it was Guardian's responsibility to familiarize itself with those requirements. See, e.g., Federal Crop Insurance Corp. v. Merrill, 332 U.S. 380 (1947).

For the reasons discussed above, this matter must be remanded to the Area Director. Presumably, at some point, Guardian will request payment on the guaranties. At that time, it will be necessary to determine how much of the claimed loss was caused by PLC's failure to maintain effective liens. Under 25 CFR 103.28(b), the guaranties may be diminished by this amount. Further, under 25 CFR 103.46, $250,000 may be excluded from the second guaranty. As to the possibility of fraud or misrepresentation, it is apparent that an investigation will be necessary to elicit the necessary facts. Perhaps BIA could call upon the Department's Office of Inspector General or other Federal investigative agency to assist in such an investigation, if it becomes necessary. 25/

Therefore, pursuant to the authority delegated to the Board of Indian Appeals by the Secretary of the Interior, 43 CFR 4.1, the Area Director's decision is affirmed in part and vacated in part. The matter is remanded to the Area Director for further proceedings as discussed in this opinion.

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Anita Vogt
Administrative Judge

I concur:

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Kathryn A. Lynn
Chief Administrative Judge

25/ At the least, the elusive loan agreements should now be obtainable. Guardian attached them as exhibits to its complaint in The Guardian Life Insurance Co. v. Reserve Industrial Authority, supra, although it did not include the exhibits with the copy of the complaint it sent to the Board.